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## Understanding and Dealing with Unsponsored ADR Programs

There have been recent changes to United States securities regulations, thereby allowing U.S. investors to trade in shares of more non-U.S. companies than was previously possible. Many of the companies that have been the target of this trading were caught unaware by these developments, have expressed concern that they may not meet the requirements necessary for that trading to occur and are unsure what they should do in response. This memorandum attempts to address these questions and concerns.

### Introduction

The United States Securities and Exchange Commission (the "SEC") recently adopted amendments to Rule 12g3-2(b) promulgated under the United States Securities Exchange Act of 1934 (the "Exchange Act") and modified certain provisions of Form F-6, which is the registration statement form used to register depositary shares evidenced by American depositary receipts ("ADRs").<sup>1</sup> As a result of these amendments, depositary banks have established unsponsored ADR programs that allow for the trading in the United States of the equity securities of hundreds of non-U.S. companies.

### What is an ADR Program?

ADRs are a type of certificate issued by a depositary bank that represents a certain number of ordinary shares of a non-U.S. company that have been deposited with the depositary bank to underlie such certificates. ADRs enable U.S. investors to invest indirectly in the securities of a non-U.S. company whose ordinary shares they would not otherwise want or be able to hold. ADR programs make it easier and more attractive for U.S. investors to invest in non-U.S. companies by,

among other things, making available U.S. dollar-denominated share price information and converting dividend payments to U.S. dollars.

### What are the different types of ADR programs?

An ADR program may be sponsored or unsponsored depending upon the issuer's involvement in the program.

#### Sponsored programs

In a sponsored program, the non-U.S. company whose ordinary shares underlie the ADRs is a party to the agreement governing the arrangement (known as a "deposit agreement") along with the depositary bank and is able to exercise control regarding the terms and conditions of the ADR program, including how many ADRs are registered for trading and what rights the holders of those ADRs are granted. The depositary bank will generally arrange for holders to exercise voting rights and to receive shareholder communications. Sponsored ADRs are issued by a single depositary bank and cannot be duplicated by another depositary bank. Sponsored ADR programs also offer the benefit of allowing the issuer to know how many ADRs are outstanding and who is holding the ADRs, which can be helpful for investor relations. This

<sup>1</sup> <http://www.sec.gov/rules/final/2008/34-58465.pdf>

information is usually communicated to the issuer by the depositary bank in the form of a periodic report.

### Un-sponsored programs

An unsponsored ADR program is one that is established by a depositary bank without the participation or consent of the issuer. Since an issuer is not involved in the implementation or in the maintenance of the unsponsored ADR program, it has limited or no influence on the treatment of ADR holders. In addition, it is possible that competing depositary banks will create multiple unsponsored ADR programs for the same issuer. Since shareholder services may vary from one depositary bank to another, this could result in investor confusion. For example, U.S. dollar disbursements may differ in some cases for the same dividend payment, depending on the foreign exchange rate applied by each of the depositary banks. In addition, each depositary bank has its own fee schedules relating to the services it provides to U.S. investors. Unsponsored ADR programs are considered less favorable to issuers and investors, partly due to the lack of control by issuers.

The existence of an unsponsored ADR program may also make it more difficult for a company to establish its own ADR program should it wish to do so. An issuer seeking to establish a sponsored ADR program when an unsponsored ADR program is already in existence is required to ensure that the depositary bank of the unsponsored program transfers the deposited securities and the related ADR holders to the new sponsored facility and terminates the unsponsored facility. The SEC may require written confirmation from the depositary bank of the unsponsored program that it agrees with such arrangements. This can potentially create a roadblock to issuers wishing to establish a sponsored ADR program.

### What does the recent rule change mean for me?

Rule 12g3-2(b) is the principal exemption relied upon by non-U.S. companies whose securities are not listed in the United States to avoid Exchange Act registration

under Section 12(g) and related disclosure requirements that would otherwise be triggered by having a broad U.S. shareholder base (*i.e.*, 300 or more U.S. resident shareholders). Non-U.S. companies have typically applied for Rule 12g3-2(b) exemptions to establish unlisted, sponsored depositary facilities for their ADRs traded in the U.S. over-the-counter (OTC) markets. In the past, unsponsored ADR programs could not be established unless a non-U.S. issuer formally applied for such exemption by submitting documents to the SEC. The recent amendments to Rule 12g3-2(b) eliminate the written application process that used to be required and provide for the automatic availability of the exemption so long as required company information is made available on the company's website. The amendments, while intended to improve the trading liquidity of non-U.S. companies, also facilitated the establishment of unsponsored ADR programs. This is because Form F-6, the form used by depositary banks to register ADRs with the SEC, was also amended to provide that depositary banks may rely in good faith on the adequacy of a company's website postings required under new Rule 12g3-2(b) for purposes of satisfying one of the conditions to filing the Form F-6. The existence of these unsponsored ADR programs and the potential shareholder interest they often generate could potentially cause a non-U.S. company's U.S. shareholder base to equal or exceed 300 holders, thereby triggering the registration requirements under Section 12(g) without the issuer taking any action itself. They also have the indirect effect of attracting investors' attention to a non-U.S. company's website.

### Why do depositary banks establish unsponsored ADR programs?

Since non-U.S. issuers meeting the relevant requirements of new Rule 12g3-2(b) are automatically exempt from registration, any depositary bank can unilaterally establish an unsponsored ADR program in anticipation of, or in response to, investor and broker demand in the U.S. for such issuer's equity securities. Depositary banks are incentivized to create ADR programs to meet this demand because they can

generate substantial revenues from investors in the form of fees for issuing and cancelling ADRs.

### How do I know if a depositary bank has created an unsponsored ADR program relating to my company?

The best way to do this is to check the SEC website at <http://www.sec.gov/edgar/searchedgar/companysearch.html> and enter your company name. If the results show that a Form F-6 has been filed, then an ADR program has been established for your company's shares.

### What are my options if an unsponsored ADR program has been established for my company?

#### Maintain the Number of Beneficial Holders at Less Than 300

One option is to ensure that the number of your company's U.S. shareholders is less than 300 as of each fiscal year end, thereby exempting you from registration under the Exchange Act by satisfying Rule 12g3-2(a). This can be done by counting the number of shareholders yourself (which can be a difficult process since SEC rules require you to "look-through" holders of record to determine who the actual beneficial holders are) or hiring an outside expert that specializes in tabulating this type of shareholder information. The advantage of this option is that it only requires you to monitor the number of beneficial holders. You will not need to satisfy the disclosure and other requirements in order to rely upon the Rule 12g3-2(b) exemption. It does not, however, eliminate any existing unsponsored programs or the risk that new unsponsored programs will be created.

#### Proactively Seek a 12g3-2(b) Exemption

Another option is to actively seek Rule 12g3-2(b) exemption status (further discussed below) by fulfilling the limited disclosure requirements (by posting

required information on your website or through an electronic information delivery system), thereby eliminating the need to follow the stricter SEC reporting requirements in the event the number of U.S. shareholders equals or exceeds 300. This option does not, however, eliminate any existing unsponsored programs nor does it prevent the creation of new unsponsored programs.

#### Establish a Level 1 Sponsored ADR Program

Another option is to establish a Level 1 sponsored ADR program. In such a case, the depositary bank selected to implement the sponsored ADR program will request that the depositary bank(s) that have established the unsponsored program(s) withdraw the unsponsored program(s). The depositary bank(s) that have established the unsponsored program(s) will typically request to be compensated for any losses associated with termination of the unsponsored program(s). Depositary banks have sometimes been willing to pay the depositary bank(s) that have established the prior unsponsored program(s) in order to establish a sponsored ADR program in anticipation of the future fees they can generate from the ADR investors.

The advantage of this option is that it eliminates any unsponsored program(s), resulting in your company enjoying the benefits of a sponsored program, such as being able to decide how many ADRs to register and having control over what rights to grant to the holders. By sponsoring an ADR program with a single depositary bank, an issuer can exercise a degree of control over how its ADR facility is operated and can ensure that its ADR holders are treated fairly and consistently. Establishing a Level 1 sponsored ADR program would require qualifying for a Rule 12g3-2(b) exemption, entering into a deposit agreement with a depositary bank and filing a Form F-6. These requirements are discussed in more detail below.

#### Communicate with the Depositary Bank that Established the Unsponsored ADR Program

This may be the preferred option in the situation where a depositary bank has established an unsponsored ADR program based on your website content despite the fact

that the posted disclosure falls short of the requirements of Rule 12g3-2(b). The depositary bank may agree to withdraw the unsponsored program if it is informed that the issuer is not Rule 12g3-2(b) compliant. However, this would not prevent other depositary banks from creating new unsponsored programs. One way to protect against further unsponsored programs would be to state prominently on your website that the information provided is not sufficient to satisfy Rule 12g3-2(b). This needs to be balanced with any investor relations concerns relating to the possible perception that the company is reducing or opting for less disclosure to its existing shareholders.

### How do I claim the Rule 12g3-2(b) exemption?

Rule 12g3-2(b), as recently amended, provides for the automatic availability of the exemption for a foreign private issuer (as defined under the Exchange Act) that (i) has a listing outside the United States, (ii) is not a reporting company under the Exchange Act and (iii) posts required information on its website or through an electronic information delivery system.

To meet the electronic publishing requirement, you must publish in English, on your website or through an electronic information delivery system that is generally available to the public in your primary trading market, information that, from the first day of your most recently completed fiscal year, you have:

- made public or been required to make public pursuant to the law of your country of incorporation, organization or domicile;
- filed or been required to file with the principal stock exchange in your primary trading market on which your securities are traded and which has been made public by that exchange; and
- distributed or been required to distribute to your security holders.

### How do I establish a Level 1 sponsored ADR program?

In a Level 1 ADR program<sup>2</sup>, the ADRs are not listed on a U.S. stock exchange, but trade in the OTC market, most commonly through the so-called “Pink Sheets” electronic market<sup>3</sup>. A Level 1 ADR program does not constitute a formal listing but still permits U.S. residents and others to trade in U.S. dollar-denominated securities. The establishment of such a program does not trigger reporting obligations or the need to comply with U.S. securities law, including Sarbanes-Oxley Act requirements. To establish a Level 1 sponsored ADR program, the following three principal steps are required:

- qualify for a Rule 12g3-2(b) exemption (see above);
- sign a deposit agreement among your company, the depositary bank and the ADR holders that detail the rights and responsibilities of each party; and
- file Form F-6 with the SEC to register the ADSs under the 1933 Act. The Form F-6 is signed by the depositary bank, your company and your directors and officers. Financial statements and a description of your business are not required to be included in a Form F-6 registration statement.

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<sup>2</sup> Among sponsored programs, there are three principal levels of programs. Level 2 ADR programs refer to a company listing its ADRs on an exchange or quoting them on NASDAQ. To qualify a company must comply with the registration and reporting requirements of the 1934 Act as well the listing requirements of the relevant exchange. Level 3 ADR programs refer to an ADR program used in connection with the raising of capital through a public offering of securities and contemporaneous listing on an exchange or quotation on NASDAQ. Level 3 ADR programs require registration of the underlying shares and ADRs under the 1933 Act and compliance with the reporting requirements under the 1934 Act.

<sup>3</sup> Level 1 ADRs are not eligible for quotation on the Over-the-Counter Bulletin Board (OTCBB), as this market only accepts the securities of companies that are subject to U.S. reporting requirements.

This memorandum is intended only as a general discussion of the issues addressed herein. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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